Supreme Court, U.S.
FILED
DEC 28 1986
JOSEPH F. SPANIOL, JR.
CLERK

NO. 84-1966

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CWT FARMS, INC. and CWT INTERNATIONAL, INC.,

Petitioners

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent

On Petition For Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

REPLY BRIEF FOR PETITIONERS

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LIST OF AFFILIATED COMPANIES

The affiliated companies are listed in the Petition for Writ of Certiorari.

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ARGUMENT

1. Respondent's Claim That Certiorari Is Not Warranted Because It Would Have No Effect On Petitioners' Tax Liabilities Is Clearly Wrong.

Respondent claims that this Court should not hear the Petition because Petitioners failed to heed the warning of the Tax Court to make a timely deficiency distribution to retain qualification. (R. Br., p. 8). However, Petitioners were warned only to make a distribution before the Tax Court decision became *final,* not before the Tax Court entered its decision, as Respondent claims. I.R.C. § 7481(a)(2)(B) and (C) provide that the Tax Court's decision is final at either the denial of certiorari or the issuance of mandate by this Court. The Tax Court clarified this matter in its Memorandum Sur Order dated June 9, 1983, reproduced in the Appendix, stating that the deficiency distribution must be made before its decision becomes final, otherwise it will lose jurisdiction to vacate its decision if necessary.

The Respondent's contention that the resolution of the commissions receivables issue by this Court would not affect the outcome of the case is similarly devoid of merit. If Petitioners prevail on the issue of whether the commissions receivables were qualified export assets, and make a deficiency distribution of any non-qualified assets within the thirty day period after the Tax Court's decision becomes final, the DISC could be a qualified DISC for the years at issue. *See* Treas. Reg. § 1.992-3. Thus, the commissions receivables issue is as ripe for decision in this Court as it was in the Tax Court.

2. The Eleventh Circuit And The Federal Circuit Have Incorrectly Applied This Court's Standards For Determining The Validity Of Interpretive Treasury Regulations.

The Federal Circuit has agreed with the Eleventh Circuit that the 60-day payment regulation, Treas. Reg. § 1.993-2(d)(2), is valid. *See Thomas International, Ltd. v. United States,* 773 F. 2d 300 (Fed. Cir. 1985), *reversing* 6 Cl.

Ct. 414 (1984). The Federal Circuit, like the Eleventh Circuit, has incorrectly applied the standards for determining the validity of Treasury regulations. Petitioners understand from counsel for Thomas International, Ltd. that a petition for writ of certiorari to the Federal Circuit was filed with the Court on November 18, 1985.

The Federal Circuit erroneously concluded that the statute, I.R.C. § 993(b)(3), is ambiguous. It acknowledged that Congress intended that DISCs could be nothing more than shell corporations functioning as commission agents, yet concluded that the term "accounts receivable" in the statute does not necessarily include "commissions receivable" of a DISC. 773 F. 2d. at 301 and 304. However, there is no other qualified export asset category within which commissions receivable can logically fit. The fact that a commission DISC has no sales of its own or does nothing to "earn" its commissions is irrelevant, because Congress intended that DISCs could be shell corporations with no function other than as vehicles for tax deferral on export income allocated under the DISC pricing rules. Because "accounts receivables" is the only category within which commissions allocated to a DISC logically fit, it is apparent that Congress intended a broad reading of the term "accounts receivable" in I.R.C. § 993(b)(3) to include commissions receivable. The statute is not ambiguous. Under this Court's prior rulings, Treasury's authority to promulgate regulations is more circumscribed when the statute is specific or *otherwise unambiguous. United States v. Vogel Fertilizer Co.,* 455 U.S. 16 (1982). The Federal Circuit failed to apply this standard to the challenged regulation.

The Federal Circuit also failed to adequately test the 60-day regulation under the requirement of *United States v. Vogel Fertilizer Co.,* 455 U.S. 16 (1982) that the regulation be consistent with the *language* of the statute. The challenged regulation is inconsistent with the statutory scheme of categories of qualified export assets. Under I.R.C. § 993(b), if an asset is within *one* of the categories of qualified export assets, it is a qualified export asset and does not have to meet the requirements for any other category. The Federal Circuit, however, approved the regulation on the basis that it was necessary to prevent commissions from being used as disguised producer's loans not meeting the requirements for producer's loans. In effect, the court approved a regulation which requires compliance with *more than one* statutory category of

qualified export assets.

The Federal Circuit, like the Eleventh Circuit, also failed to note the contradiction between the challenged regulation's testing of assets after the end of a DISC's taxable year and the requirement of I.R.C. § 992(a)(1)(B) that the testing of assets be conducted "at the close of the taxable year." *See* Pet. Cert., pp. 15-16.

Finally, the Federal Circuit erred in its conclusion that the challenged regulation is consistent with the language, origins and purposes of the statute. It has approved a regulation which attempts to fill a perceived loophole. The Federal Circuit endorses an interpretive regulation which adds conditions not found in the statute and it apparently ignores the line of cases in this Court holding that Treasury has no authority to add conditions, amend, or contradict the statute through its interpretive regulations. *See, e. g., Morrill v. Jones,* 106 U.S. 466 (1883); *Lynch v. Tilden Produce Co.,* 265 U.S. 315 (1924); *Helvering v. Credit Alliance Corp.* 316 U.S. 108 (1942). If the challenged regulation merely had interpreted "accounts receivable" to include commissions receivable, as Congress intended, without attempting to protect the producer's loan provisions, it would be reasonable and consistent with the language, origin, and purposes of the statute. Treas. Reg. § 1.993-2(d)(2), however, amends the statute and adds a conclusive presumption against the taxpayer which finds no basis in the statutory language or in the legislative history concerning commission DISCs.

CONCLUSION

Petitioners request the Court to grant the petition for certiorari to the Eleventh Circuit.

Respectfully submitted,

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APPENDIX

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

CWT FARMS, INC., ET AL.,
Petitioners,

v.

16365-80
Docket Nos. 16367-80

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

MEMORANDUM SUR ORDER

On July 19, 1982, this Court filed its Findings of Fact and Opinion in this case (79 T.C. 86). The petitioners moved for reconsideration of the opinion, such motion was granted, and a Supplemental Opinion was filed on December 23, 1982 (79 T.C. 1054). On May 10, 1983, the petitioners, with leave of Court, filed a second motion for reconsideration.

The petitioners have asked that we clarify that portion of the supplemental opinion concerning the determination of the validity of a deficiency distribution. We stated that such determination "must necessarily await International's attempt to comply with the requirements of section 992(c). At that time, we can decide whether the reasonable cause requirements of such provision have been satisfied." 79 T.C. at 1059. We do not find the language to be unclear. The petitioners certainly have the right to seek review of our determination that International did not qualify as a DISC, but if they seek that review and do not make a deficiency distribution until the Court of Appeals acts, then we cannot determine the efficacy of such distribution until that time. If such a distribution is made, a motion to vacate decision pursuant to Rule 162, Tax Court Rules of Practice and Procedure, made before our decision becomes final,[1] would suffice to place the reasonable cause issue before us. In deciding whether to grant leave to file such motion, the Court will consider that it is necessary to hear such motion in order to carry out the congressional objective of per-

[1] Our decision becomes final within 90 days after the entry of the Court of Appeals judgment affirming such decision unless a petition for certiorari has been filed in that time. Sec. 7481(a)(2)(A), Internal Revenue Code of 1954; 28 U.S.C. sec. 2101(c).

mitting deficiency distributions after a corporation has been found not to qualify as a DISC.

The petitioners also ask us to reconsider our statement that International must make a deficiency distribution before our decision becomes final in order for us to determine the validity of such distribution. The petitioners misunderstood the basis of our statement. We were merely pointing out the need to make the distribution promptly; we did not hold that "a res judicata theory" would preclude us from vacating a final decision. We stated that this Court is *without jurisdiction* to vacate, modify, or reconsider a final decision except in special circumstances not apparently present here. 79 T.C. at 1059. We expressed no opinion concerning the res judicata effect of a final decision on other legal proceedings in other courts.

For the foregoing reasons, the petitioners' second motion for reconsideration of opinion will be denied.

(Signed) CHARLES R. SIMPSON
Judge

Dated: Washington, D.C.
June 9, 1983